BRIEF FOR THE RESPONDENT IN OPPOSITION

In The

Supreme Court of the United States

October Term, 1947

No. 720

Commissioner of Internal Revenue,
Petitioner,

v.

Allan S. Lehman

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Ellsworth C. Alvord
Floyd F. Toomey
1200 18th Street, N. W.
Washington 6, D. C.
Counsel for Respondent

Wilson - Epes Printing Co. - RE 6003 - Washington 1, D. C.

INDEX

Citations

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 720

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ALLAN S. LEHMAN

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of The Tax Court of the United States (R. 3-26) is reported at 7 T. C. 1088. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 32-38) is reported at 165 F. (2d) 383.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Second Circuit (R. 39) was entered on January 5, 1948. (R. 40) Petition for a writ of certiorari was filed April

5, 1948. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. (U. S. C. A., Title 28, section 347 (a))

QUESTIONS PRESENTED

1. When the taxpayer on January 1, 1937 sold a fractional share of his property rights or interest in Lehman Brothers, a co-partnership under New York Law, is the holding period under section 117 (a) of the Revenue Act of 1936 to be measured from the date of acquisition by the taxpayer of the property rights or interest sold, or is such holding period to be measured from the date or dates of the acquisition by the partnership of its specific assets?

2. What effect, if any, did the death of one of the partners of Lehman Brothers on May 16, 1936 have on the holding period of the fractional share of the property rights or partnership interest sold by the taxpayer on January 1, 1937?

3. Was the fractional share of the property rights or partnership interest sold by the taxpayer identified as having been held by him for more than 10 years for the purpose of applying the percentage provisions of section 117 (a) of the Revenue Act of 1936?

STATUTES INVOLVED

The applicable provisions of the statutes involved are set forth in the appendix, *infra*, pp. 15-16.

ARGUMENT

1. The basic question specified by the Government is not in issue before this Court.

The application of section 117 of the Revenue Act of 1936 to the facts in this case requires, in the first instance, the determination of two questions (1) was there a sale or exchange of a capital asset as defined in subsection (b) and (2) how long had the capital asset been held for the purpose of applying the percentages of gain to be taken into account under subsection (a). That these involve separate determinations is shown by Article 117-1 of Regulations 94, which provides that, "In determining whether property is a 'capital asset', the period for which held is immaterial".

The basic error specified by the Government in its petition for certiorari (p. 9) is that, "The court below erred in holding that the taxpayer had sold a portion of his interest in a partnership which, without regard to the nature of the partnership assets and the length of time that they were held, was a capital asset * * *". By that basic specification of error, the Government challenges, and seeks to have this Court review, the correctness of the Commissioner's original determination. In the petition (p. 15), it is asserted that the issue raised is one of importance in the administration of the revenue laws because, "Likewise, the holding below might be sufficiently broad to compel the conclusion that the sale of a partnership interest would be a sale of a capital asset even though the assets used in the business are non-capital in nature". Yet, that is precisely what the Commissioner determined here.

The property of Lehman Brothers on January 1, 1937 consisted both of capital and non-capital assets. (R. 31) In other words, a substantial portion of the specific assets of the firm consisted of securities held "for sale to cus-

tomers in the ordinary course of [its] trade or business", and as such were excluded from the definition of "capital assets" under section 117 (b). The Commissioner in his notice of deficiency determined that what the taxpayer sold on January 1, 1937 was "a fractional interest in Lehman Brothers partnership" and that the entire gain therefrom of $99,899.98 was a capital gain, *i. e.,* gain from the sale of a capital asset. (R. 3-4)[1] That the Commissioner determined that the capital asset sold was an interest in the partnership distinct from the specific partnership assets is conclusively shown by the fact that in computing the capital gain he made no segregation between the capital and non-capital assets.[2] (R. 31, 4) The correctness of his determination in that respect was not questioned by the Government, either in the Tax Court or in the Circuit Court of Appeals. Thus, paraphrasing the Government's basic specification of error here, the Commissioner in his notice of deficiency determined that the taxpayer sold a portion of his interest in a partnership which, without regard to the nature of the partner-

---

[1] The pleadings are not included in the record filed by the Government in this Court. They are, however, a part of the record on file with the Circuit Court of Appeals. In paragraph 5 (b) of the petition before the Tax Court, it was alleged that "Petitioner sold a part of his interest in the said partnership". In paragraph 5 (b) of his answer, the Commissioner stated "* * * it is admitted that the petitioner sold a fractional interest in the partnership known as Lehman Brothers".

[2] The fact that the Commissioner computed the capital gain in this manner is a strong indication that the Government at page 15 of its petition has exaggerated the importance of the matter.

ship assets and the length of time that they were held, was a capital asset.[3]

Having made the determination, described above, under subsection (b), the Commissioner determined that the holding period for the purpose of applying the percentage rates specified in subsection (a) of section 117 should be "measured from the date or dates of acquisition by the partnership of the specific partnership assets which the partnership owned at the date of sale of the fractional interest". (R. 3-4) It was this latter determination which the taxpayer placed directly in issue before the Tax Court. (R. 4)

Because of the Commissioner's original determination and the state of the pleadings, the Government is in the wholly untenable position on this record of having admitted that under subsection (b) the capital asset sold consisted of a fractional interest in a partnership distinct from the specific partnership assets, and of having to contend that under subsection (a) of section 117 the holding period should be measured, not from the date of the acquisition of the asset sold, but from the date or dates of acquisition by the partnership of the specific assets owned at the date of the sale. Because of this dilemma, the Government, by its basic specification of error, seeks to challenge in this Court the correctness of the Commis-

[3] The Commissioner's determination was in accordance with the theory of his own regulations. Article 113 (a) (13)-2 of Regulations 94 provides:

> "When a partner retires from a partnership, or the partnership is dissolved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. * * *"

This is a clear administrative recognition that the interest of a partner in a partnership is an asset distinct from his interest in the property of the firm, that it may be disposed of and that gain or loss may be computed thereon as in the case of any other asset. Substantially, the same regulation has been in effect since 1918. (See: *Helvering v. Walbridge*, 70 F. (2d) 683, 684 (C. C. A. 2))

sioner's original determination under subsection (b). That the taxpayer sold a capital asset which consisted of an interest in a partnership distinct from the specific partnership assets is not in issue in this case. Since the other matters raised in the petition for certiorari are admittedly subordinate to the basic specification of error (p. 16), the petition should be denied.

2. The property sold was a capital asset consisting of an intangible interest in a partnership distinct from the specific partnership assets.

Aside from the assertion that the issue specified is one of importance in the administration of the revenue laws, the Government states two grounds for the issuance of the writ: (1) that the decision below is in direct conflict with that of the Court of Claims in *City Bank Farmers Trust Company,* 47 F. Supp. 98 (1942); and (2) that the decision below is erroneous in holding that a partner has a property right in the partnership business which is distinct from his interest in the partnership assets and which may be the subject matter of a taxable transfer. These will be discussed in reverse order. The unimportance of the issue will appear from that discussion.

The Tax Court found as a fact that: "As of January 1, 1937, on the admission of new capital partners to Lehman Brothers, the petitioner * * * sold a fractional part of his property rights in the partnership * * *. The property rights sold by the petitioner to the buying partners constituted a fractional share of his interest in the partnership." In 1928, this Court in *Blodgett v. Silberman,* 277 U. S. 1, passed squarely upon the nature of such an interest. Specifically, it decided that Connecticut could include as part of the gross estate, for the purpose of the state inheritance tax, the value of the deceased's interest in a New York partnership, which, among other assets, owned New York real estate and tangible personal property which would not have been taxable if owned directly by the decedent. Speaking of the New York Partnership Law, Chief Justice Taft said:

"Under § 51 of this law, a partner is a co-owner with his partner of specific partnership property, holding this property as a tenant in partnership. Such tenancy confers certain rights with limitations. A partner has a right equal to that of his partners to possess specific partnership property for partnership purposes, but not otherwise. His right in specific partnership property is not assignable nor is it subject to attachment or execution upon a personal claim against him; upon his death the right to the specific property vests not in the partner's personal representative but in the surviving partner; his right in specific property is not subject to dower, curtesy, or allowance to widows, heirs or next of kin.

"Section 52 specifically provides:

'A partner's interest in the partnership is his share of the profits and surplus and the same is personal property.' "

* * * *

"It is very plain, therefore, that the interest of the decedent in the partnership of William Openhym & Sons was simply a right to share in what would remain of the partnership assets after its liabilities were satisfied. It was merely an interest in the surplus, a chose in action. It is an intangible and carries with it a right to an accounting." (pp. 10-11)

Thus, it is clear that this Court there held that a partner in a New York partnership has a property right in the business of the firm which is distinct from his interest in the partnership assets and which may be the subject of a taxable transfer.[4] Similarly, as early as 1928, the Board of Tax Appeals applied this principle in the application of the federal tax laws. (See: *Sam H. Harris,* 11 B. T. A. 871, 874-875 (1928), *aff'd,* 39 F. (2d) 546; *Henry Wilson,* 16 B. T. A. 1280, 1287 (1929)) In 1934, in *Helvering v. Walbridge,* 70 F. (2d) 683, which involved a question closely analogous to that presented here, the court below

[4] The court below assumed for the sake of argument that for federal tax purposes the Uniform Partnership Act in force in New York should be ignored. It reached the same conclusion "upon the basis of the law as it was before it was codified" as this Court reached in the *Blodgett* case. (R. 34-36)

held that property contributed by a partner became a firm asset, that the partner no longer had any effective power over it and, therefore, no interest in it "save as it might figure in 'his share of the profits and surplus' ". (p. 685) This Court denied the Government's petition for certiorari. (293 U. S. 594)

Likewise, with respect to the specific question raised here, as early as 1935 the Board of Tax Appeals in *Dudley T. Humphrey,* 32 B. T. A. 280, held that the sale of an interest in a New York partnership, the specific assets of which were non-capital in character, constituted the sale of a capital asset under section 101 of the Revenue Act of 1928. In so holding, the Board said:

> "Now, applying the above holdings to the present case, it would appear that what petitioner sold to his partners was an intangible consisting of his right to a share in the net value of the partnership after settlement of its affairs. He had no interest in the assets of the partnership as such; consequently, what he sold was not a portion of or an interest in the partnership securities. His interest in the partnership was separate and distinct from his coownership of the partnership assets and the length of time of his ownership of the partnership interest is not measurable by the period of time that the partnership had owned the securities on hand at the time he sold his interest. * * *" (pp. 283-284)

Though the issue was squarely presented in its broadest scope, the Commissioner merely noted his non-acquiescence (XIV-2 C. B. 34) but did not appeal. In 1940, the Board reaffirmed its position in *Morris Shapiro* (Memo. Dec., CCH Dec. 10,991(G)). The Government appealed but the Circuit Court of Appeals affirmed. (*Commissioner v. Shapiro,* 125 F. (2d) 532 (C. C. A. 6th, 1942)) In 1941, the United States District Court for the Eastern District of Pennsylvania in *Kessler v. United States,* 29 A. F. T. R. 1314, decided substantially the same issue in favor of the taxpayer. On appeal, the Circuit Court of Appeals reversed on other grounds *Kessler v. United States,* 124 F.

(2d) 152 (C. C. A. 3d, 1941). Later, the same question arising out of the same transaction as was involved in the *Kessler* case reached the Circuit Court of Appeals in the case of another partner in *Thornley v. Commissioner*, 147 F. (2d) 416 (C. C. A. 3d, 1945). The decision was in favor of the taxpayer. To the same effect are the decisions in *Stilgenbaur v. U. S.*, 115 F. (2d) 283 (C. C. A. 9th, 1940); *McClellan, et al, v. Commissioner*, 117 F. (2d) 988 (C. C. A. 2d, 1941); *Williams v. McGowan*, 152 F. (2d) 570 (C. C. A. 2d, 1945); *L. F. Long* (T. C. Memo Dec., 1947, CCH Dec. 15,840(M)); *Estate of Daniel Gartling* (T. C. Memo. Dec., 1947 CCH Dec. 15,945(M)); and *H. R. Smith*, 10 T. C. .... No. 49 (1948). See also: *Hill v. Commissioner*, 38 F. (2d) 165, 168 (C. C. A. 1st, 1930); *Adler, et al, v. Nicholas, et al*, ... F. (2d) .... (C. C. A. 10th), decided March 5, 1948 (CCH Par. 9205); *Robert E. Ford*, 6 T. C. 499 (1946); and *George Whitney*, 8 T. C. 1019 (1947).

Thus, the basic issue raised here has been decided adversely to the Government in principle by this Court in *Blodgett v. Silberman, supra*, and directly by the Tax Court in decisions dating back thirteen years, and in the meantime, by the Circuit Courts of Appeal for the Second, Third and Sixth Circuits. The decision below is in accord with the prevailing and elementary rule announced in these cases.

The decision below is consistent with the special treatment by Congress of partnerships for federal tax purposes. Had Congress intended to adopt the ancient common law concept of a partnership, there would have been no occasion for dealing with partnerships separately and in detail. (Secs. 181-188, Revenue Act of 1936) Those provisions are obviously inconsistent with the early common law concept. This Court in *Neuberger v. Commissioner*, 311 U. S. 83, pointed out that, "In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individ-

uals". (p. 88) (*Cf., Guaranty Trust Co. v. Commissioner,* 303 U. S. 493) The rule adopted by the Tax Court and the Circuit Court of Appeals is simpler from the standpoint of administration than that advocated by the Government. It is not suggested by the Government that the application of that rule adversely affects the revenue.

3. The decision of the Court of Claims in City Bank Farmers Trust Company, 47 F. Supp. 98 (1942), furnishes no substantial basis for the granting of the writ.

The primary reason advanced by the Government for the granting of the writ is the asserted conflict between the decision below and that of the Court of Claims in the *City Bank Farmers Trust Company case.* In that case, as in this, the sole question squarely presented was whether "when a partner sells his interest in a partnership business, the holding period for the purpose of applying the percentage rates specified in section 117 of the Revenue Act of 1936 * * * is to be measured from the date of the partner's acquisition of the partnership interest, or whether the holding period is to be measured from the date or dates of acquisition by the partnership of the specific partnership assets which the partnership owned at the date of sale of the partner's interest". (p. 103) On that question, the decision of the Court of Claims is in conflict with the decision below. However, on the basic error specified here, *i. e.,* the nature of the interest sold, it is implicit in the findings and opinion of the Court of Claims that the Commissioner in that case, as in this, determined that the interest sold was a capital asset distinct from the specific partnership assets. This is shown by the fact that the partnership there involved "was engaged in transacting a general brokerage business in stocks, bonds and other securities and commodities" (p. 99), and that in computing the capital gain, apparently no segregation was made between capital and non-capital assets (p. 101).

Thus, the statements of the Court of Claims, like those in the Government's petition here, to the effect that the interest sold was a prorata interest in specific assets, was contrary to the Commissioner's own determination and, therefore, irrelevant.

In any event, the reasoning of the Court of Claims that for federal tax purposes a partnership must be considered as an association of individuals who are vested with a direct pro-rata interest in the specific property of the firm conflicts in principle with the decision of this Court in *Blodgett v. Silberman, supra.* It is clearly out of harmony with the otherwise unbroken line of decisions by the Tax Court and by several Circuit Courts of Appeal dealing specifically with the capital gain and loss provisions of the federal revenue acts.

In reverting to the ancient common law concept that the property of a partnership is held not by the firm, but by the partners in common, the Court of Claims ignored the fact that long before the adoption of the Uniform Partnership Act by many of the states the early common law concepts had been modified so as to impound firm assets and to deprive individual partners of any control over them except in so far as they were dealing with them on behalf of the firm as a unit. (*Case v. Beauregard,* 99 U. S. 119 (1879). As the court below pointed out, the Uniform Partnership Act codified these modifications and made no substantial change when it declared in so many words that "a partner's interest in the partnership is his share of the profits and surplus" (R. 34-35), and "it was upon this traditional structure that Congress fitted the taxation of partnerships". (R. 34)

Over three years ago, the Circuit Court of Appeals for the Third Circuit in *Thornley v. Commissioner,* 147 F. (2d) 416 (1945), refused to follow the decision of the Court of Claims in the *City Bank Farmers Trust Company* case.

In spite of the conflict, the Government did not apply for certiorari. If the question were as important as the Government now asserts, it should have taken steps to resolve the conflict at that time. We submit that at this late date the decision of the Court of Claims should be regarded as an isolated and erroneous pronouncement with respect to an otherwise well-settled and elementary rule of law.

4. Under section 117 (a) of the Revenue Act of 1936, the holding period of a "capital asset" must be related to the time the asset sold was held by the taxpayer.

As we observed at the outset, this is really the only question in issue here. Once it is determined, as the Commissioner determined here and as the Tax Court and the court below agreed, that the asset sold consisted of an intangible, and not a pro-rata interest in specific partnership assets, it is too clear for argument that the holding period, under the precise terms of section 117 (a) must be related to the time the asset sold was held by the taxpayer and not to the time the assets of the partnership were held by the firm. Otherwise, it would be possible for a member of a partnership owning his interest for less than one year to have capital gain computed on the basis of the reduced percentages applicable to a holding period longer than that during which he held any interest in the firm.

5. In no event should the alternative issues be reviewed by this Court.

Arthur Lehman, one of the members of Lehman Brothers, died less than a year prior to the sale by the taxpayer of his fractional interest in the firm. The surviving partners, as they were entitled to do under the partnership agreement, continued the business. The Government contended that as a result of the death of Arthur Lehman a new partnership came into existence, which started a new holding period for the interests of the surviving partners. The contention was rejected both by the Tax

Court (R. 22-25) and by the Circuit Court of Appeals (R. 36-37). A related question was decided by this Court in *Heiner v. Mellon,* 304 U. S. 271, 277 (1938).

In deciding the issue, the Tax Court relied upon its previous decision in *Robert E. Ford,* 6 T. C. 499 (1946). In that case, the Tax Court rejected substantially the same contention made by the Commissioner concerning the effect of the withdrawal of a partner and the Commisisoner acquiesced. (1946—2 C. B. 2) In *Mary D. Walsh,* 7 T. C. 205 (1946), the Commissioner contended that the death of a partner terminated the "taxable year of the partnership" as that phrase is used in section 188 of the Internal Revenue Code. The Tax Court rejected the contention and the Commissioner again acquiesced. (1946—2 C. B. 5) Clearly, the analogous question raised here concerning the effect of the death of Arthur Lehman is of no public importance.

The Government also contended below that the taxpayer had not identified the fractional interest sold as having been held by him for more than ten years. This contention raised a question of fact, which the Tax Court resolved in favor of the taxpayer. (R. 19-22) Its decision thereon is entitled to the finality accorded such determinations by *Dobson v. Commissioner,* 320 U. S. 489. In any event, the narrow issue is peculiar to this case and not of general interest.

CONCLUSION

The basic question specified by the Government is not in issue before this Court. Further, the interest sold, which was admittedly a capital asset, consisted of a chose in action, an intangible interest in a partnership, and not a direct pro-rata interest in specific partnership assets. Despite the observations of the Court of Claims to the contrary, the principle is so universally recognized that at

this late date further clarification by this Court is unnecessary. Indeed, the reversal by this Court, at this late date, of a principle so firmly embedded in American tax law would create needless confusion. Further, if the question were as important as the Government now asserts, it should have appealed the decision of the Board of Tax Appeals in the *Humphrey* case in 1935 and have applied for certiorari at least three years ago in the *Thornley* case. The petition for certiorari should be denied. In no event should the alternative issues be reviewed by this Court.

Respectfully submitted,

Ellsworth C. Alvord
Floyd F. Toomey
1200 18th Street, N. W.
Washington 6, D. C.

Counsel for Respondent

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

New York Partnership Law, Chapter 39, Consolidated Laws of New York:

§ 50. *Extent of property rights of a partner.* The property rights of a partner are (a) his rights in specific partnership property, (b) his interest in the partnership, and (c) his right to participate in the management.

§ 51. *Nature of a partner's right in specific partnership property.* 1. A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

2. The incidents of this tenancy are such that:

(a) A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.

(b) A partner's right in specific partnership property is not assignable except in connection with the assignment of the rights of all the partners in the same property.

(c) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

(d) On the death of a partner his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.

(e) A partner's right in specific partnership property is not subject to dower, curtesy, or allowances to widows, heirs, or next of kin.

§ 52. *Nature of partner's interest in the partnership.* A partner's interest in the partnership is his share of the profits and surplus and the same is personal property.